

BEFORE THE STATE BOARD OF EQUALIZATION  
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of	)	
	)	
Kelly Service, Inc., and	)	No. 94R-0909
Subsidiary Corporations	)	

Representing the Parties:

For Appellant:	Robert F. Stoner, CFO
For Respondent:	Debra S. Peterson, Tax Counsel

OPINION

This appeal is made pursuant to section 25666<sup>1</sup> of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Kelly Services, Inc., against proposed assessments of additional franchise tax in the amounts of \$1,501 and \$1,331 for the income years ended December 31, 1989 and December 31, 1990, respectively, and pursuant to section 26075, subdivision (a), from the action of the Franchise Tax Board in denying the claims of Kelly Services, Inc., for refund of the franchise tax in the amounts of \$18,731, \$18,034, \$17,357, \$12,140, and \$17,191 for the income years ended December 31, 1988, December 31, 1989, December 31, 1990, December 31, 1991, and December 31, 1992, respectively.

In this appeal, we revisit the Michigan Single Business Tax (MSBT), which we last considered in the Appeal of Dayton Hudson Corporation (94-SBE-003) decided on February 3, 1994. The issue is whether the MSBT may be deducted on a California franchise tax return under section 24345, subdivision (b), which provides that a tax paid to another state is nondeductible if it is “on or according to or measured by income and profits paid or accrued within the income year.” In Dayton Hudson, we concluded that the MSBT is measured by something other than gross income and was therefore deductible. In the case before us, we decline respondent’s efforts to treat the MSBT as a “multi-faceted” tax and conclude that the MSBT measures economic activity and is not an income tax. The MSBT may be deducted on a California franchise tax return when the ultimate base upon which the tax is measured does not contain a return of capital in the context of a service intensive business. We affirm Dayton Hudson and clarify that its holding applies equally to service businesses.

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<sup>1</sup>Unless otherwise specified, all section references are to sections of the Revenue and Taxation Code as in effect for the income years in issue.

The MSBT is a value added tax which differs greatly from a normal corporate income tax in both its conception and its computation (Trinova Corporation v. Michigan Department of Treasury (1991) 498 U.S. 358, 366 [112 L.Ed.2d 884]). The starting point for its computation is federal taxable income--this is also where the MSBT deviates from any resemblance to a tax measured by income and profits. Unlike a traditional income tax, Michigan does not allow deduction from gross income of many items which are routinely deducted for traditional income tax purposes, such as labor cost, interest and depreciation, but does allow deduction of income derived from partnerships, interest and dividends received, among other deductions not normally recognized in traditional income tax calculations.<sup>2</sup> After these calculations have taken place, an apportionment formula and other adjustments may be applied. The resulting figure, after all these calculations, is designated by Michigan as the "tax base," against which the MSBT is applied.

The purpose of the various additions and subtractions from taxable income is to broaden the "tax base" beyond profits, which is the usual "tax base" upon which an income tax is imposed. These modifications to taxable income are done in order to draw in other components of the taxpayer's economic activity, including its use of labor, capital equipment, and financial resources. In practice, this can result in a sizable "taxable base" upon which tax is imposed, even when profits are nonexistent and no tax would be due on a traditional income tax basis. (Trinova, supra, 498 U.S. at 363-364.)

Gross income for federal tax purposes in a manufacturing, merchandising or mining business is defined as gross receipts less cost of goods sold. (Treas. Reg. § 1.61-3(a).) Although the MSBT does not include the material or acquisition cost of goods sold when determining the MSBT tax base, it does include the cost of labor. For that reason, in Dayton Hudson we held that the imposition of the MSBT against a base which includes the cost of labor, without exclusion of the labor cost of goods sold, results in a tax which is measured by something other than gross income, and is therefore deductible under section 24345, subdivision (b).

Appellant now asks us to expand our holding in Dayton Hudson to encompass situations where there is no labor cost of goods sold in the MSBT tax base for a particular taxpayer. As appellant stipulated in its appeal letter "Kelly is a service business providing temporary help to a variety of customers. As a service business, it has no inventory costs" and thus the MSBT, as applied to it, does not "contain an element of return of capital" in Kelly's tax base. (App. Br. at 2.)

Respondent, relying on our decision in Dayton Hudson, and on Robinson v. Franchise Tax Board, (1981) 120 Cal.App.3d. 72, has sought to limit the deductibility of the MSBT to taxpayers who can demonstrate that they incurred and deducted the labor cost of goods sold in the tax year in which the MSBT was paid or accrued. (FTB Notice 94-4, Nov. 10, 1994.) In Robinson, the Second District Court of Appeal held that the same tax may be deductible for one taxpayer, and not for another, based on the activity undertaken by the taxpayer. Such a tax is referred to as "multifaceted." (Robinson, supra at 81.)

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<sup>2</sup>For a more complete explanation of all the items contained in the calculation of the MSBT, see Schwendener, 1650 T.M., Michigan Single Business Tax, pp. 10-14.

We believe that the holding in Robinson is distinguishable from the facts in this case. Robinson involved a privilege tax imposed by the state of Hawaii on account of business or other activities in that state. (3a Hawaii Rev. Stats. (1976) ch. 237, § 237-13.) The tax in question was measured by different standards, depending upon the activity undertaken by the taxpayer. Manufacturers and retailers were taxed measured by gross proceeds of sales. (Hawaii Rev. Stats. *supra* at §§ 237-13, subd. (1)(A) and (2)(A).) Service businesses were taxed measured by gross income. (*Id.* at § 237-13, subd. (3)-(8).) The Court of Appeal thus concluded that the tax paid by a taxpayer involved in a service business or activity was a nondeductible income tax.

In this case, the MSBT makes no distinction between activities of a taxpayer when calculating the measure of tax. Thus, where Robinson may apply when the tax law itself applies different standards to different taxpayers based on their activities, it does not compel the conclusion that a tax is “measured by income” simply because the tax formula imposed may, but is not required to, include only elements of income, as opposed to return of capital, when applied to a specific taxpayer.

We therefore find that the MSBT is deductible in California under section 24345, subdivision (b), regardless of the specific components of the MSBT tax base of the taxpayer claiming the deduction. We emphasize that this decision is not intended to enunciate a general rule on all “value-added” type taxes, which must be examined on a case-by-case basis, but applies only to the Michigan Single Business Tax, as it was written during the periods involved in this appeal.

Based on the foregoing, the action of the Franchise Tax Board in denying the claims for refund is reversed.

ORDER

Pursuant to the views expressed in the opinion of the Board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED, AND DECREED, pursuant to section 26077 of the Revenue and Taxation Code, that the action of the Franchise Tax Board in denying the claim of Kelly Services, Inc., for refunds of franchise income tax in the amounts of \$18,731, \$18,034, \$17,357, \$12,140 and \$17,191 for the income tax years ended December 31, 1988, December 31, 1989, December 31, 1990, December 31, 1991 and December 31, 1992, and pursuant to section 25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Kelly Services, Inc., against proposed assessments of additional franchise tax in the amounts of \$1,501 and \$1,331 for the income years ended December 31, 1989 and December 31, 1990, respectively, be and the same are hereby reversed.

Done at Sacramento, California, this 8th day of May, 1997, by the State Board of Equalization with Board Members Johan Klehs, Dean F. Andal, Ernest J. Dronenburg, Jr., Rex Halverson\* and John Chiang\*\*, present.

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Ernest J. Dronenburg, Jr., Chairman

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Dean F. Andal, Member

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Rex Halverson\*, Member

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\*For Kathleen Connell, per Government Code section 7.9.

\*\*Acting Member, 4th District.